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Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

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PLR-144830-12

Date:

April 11, 2013

Re:

LEGEND:

Trust =
Decedent =
Date 1 =
Date 2 =
Share A =

Share B =
Charitable =
Trust

a =
Child 1 =
Child 2 =
x =
Charity 1 =

y =
Charity 2 =
z =

Charity 3 =
State =
Bank =
Year =

Agreement =
Date 3 =
Court =
Date 4 =
Amended =
Agreement

b =
c =
Article XX =
Trust

Reformed =
Charitable
Trust
Date 5 =

Dear

This letter responds to your submission dated October 10, 2012, and subsequent correspondence, requesting a ruling on the application of § 2055(e)(3) of the Internal Revenue Code to the judicial reformation of Trust.

FACTS

The facts and representations are as follows: On Date 1, Decedent created Trust as a revocable trust. On Date 2, Decedent died testate and Trust became irrevocable. Under Decedent's will, after a specific bequest of certain personal property, the residue of Decedent's property is devised to the trustee of Trust.

Article VII of Trust provides that upon the death of the settlor, the trustee shall divide the trust estate into two shares, Share A and Share B, with Share B funding Charitable Trust. Share B is to consist of a sum of money equal to the unified credit exclusion amount provided under law at the time of the settlor's death. This amount shall take into account the settlor's testamentary transfers to non-charitable beneficiaries and taxable gifts, if applicable. The remaining assets after funding Charitable Trust shall compose Share A.

Article VII of Trust provides that the trustee of Charitable Trust shall pay an annual amount of a percent of the trust corpus (one-half payable to Child 1 and one-half payable to Child 2) out of the income of the trust. The trustee is directed to invest the principal in an attempt to generate sufficient income to pay out a percent of the trust corpus. Payments of principal are prohibited. Upon the death of both Child 1 and Child 2, the principal together with any accrued income is to be distributed outright and upon the identical terms as Share A.

Article VIII of Trust provides that Share A is to be distributed outright as follows: x percent to Charity 1, y percent to Charity 2, and z percent to Charity 3.

Article XII of Trust provides, in part, that the trustee has the power to divide any trust into separate shares or separate trusts or to create separate trusts if the trustee

deems it appropriate and the division or creation is consistent with the settlor's intent and facilitates the trust's administration without defeating or impairing the interests of the beneficiaries.

Article XX of Trust provides that on the death of any person entitled to income or support from any trust under Trust, the trustee is authorized to pay the funeral expenses and the expenses of the last illness of such person from the principal of the trust from which such person was entitled to income or support.

Article XXI of Trust provides that Trust and the trusts created under Trust shall be construed, regulated, and governed by and in accordance with the laws of State.

After Decedent's death, Child 1 and Bank served as co-trustees of Trust. Certain issues arose concerning the administration of Charitable Trust and the qualification of Charitable Trust as a charitable remainder trust described in § 664. First, because Decedent died in early 2010 when the estate tax was temporarily repealed,¹ a question arose as to the amount required to fund Charitable Trust for purposes of the "unified credit exclusion amount" in Article VII of Trust. Second, Trust, as drafted, provides the trustee of Charitable Trust with the discretion to pay the noncharitable beneficiaries' funeral expenses and expenses of the last illness, which disqualifies Charitable Trust from qualifying as a charitable remainder trust under § 664. Third, Article VII of Trust, as drafted, does not include certain provisions in its governing instrument that are required for Reformed Charitable Trust to qualify as a charitable remainder trust under § 664. Finally, the distribution language in Article VII of Trust, concerning the investment of trust assets, and the change in the investment climate from the date of creation of Trust to the date of Decedent's death years later led to concern about the trustees' ability to impartially invest the trust assets in the best interests of all beneficiaries.

In Year, Child 1, as personal representative of Decedent's estate, as co-trustee of Trust, and in her individual capacity, together with Child 2, Charity 1, Charity 2, and Charity 3 entered into Agreement. Agreement was amended on Date 3 (Amended Agreement) and incorporated by reference the proposed amended and restated Article VII of Trust. As relevant here, the parties agreed as follows:

¹ The Economic Growth and Tax Relief Reconciliation Act of 2001 temporarily repealed the estate tax for estates of decedents dying in 2010. On December 17, 2010, the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (TRUIRJCA) became law and § 301(a) retroactively reinstated the estate tax. Section 301(c) of TRUIRJCA allowed estates of decedent who died in 2010 to elect to have the estate tax not apply and to have the carryover basis rules in § 1022 apply to property transferred as a result of the decedent's death. In the instant case, the personal representative of Decedent's estate did not elect under § 301(c) of TRUIRJCA to have the estate tax not apply.

1. Charitable Trust should be funded with assets having a value of \$b million, as of the date of funding, less Decedent's testamentary transfers to noncharitable beneficiaries and taxable gifts.
2. The fair market value of the noncharitable interests provided in Article XX of Trust, as of the date of Decedent's death, is \$c, as determined by multiple valuation experts who considered the foreseeable and ascertainable costs to fulfill the distribution directive under Article XX of Trust.
3. Trustees will petition Court to divide Charitable Trust into two trusts, Article XX Trust and Reformed Charitable Trust, and to fund Article XX Trust with assets valued at \$c and Reformed Charitable Trust with the remaining assets. The division will be retroactive to the date of Decedent's death.
4. Trustees will petition Court to reform Article VII of Trust, retroactive to the date of Decedent's death, to clarify that Article XX of Trust does not apply to Reformed Charitable Trust.
5. Trustees will petition Court to reform Article VII of Trust, retroactive to the date of Decedent's death, to include the administrative provisions necessary for Reformed Charitable Trust to qualify as a charitable remainder unitrust (CRUT) under § 664.
6. Trustees will petition Court to reform Article VII of Trust, retroactive to the date of Decedent's death, to provide for an annual payment from Reformed Charitable Trust of a percent of the net fair market value of trust assets, determined annually, to each noncharitable beneficiary, without an income limitation.

The relevant terms of Reformed Charitable Trust, as provided in proposed amended and restated Article VII of Trust, are as follows: (a) Reformed Charitable Trust will pay a unitrust amount of a percent to Child 1 and Child 2; (b) upon the death of the first-to-die of Child 1 and Child 2, Reformed Charitable Trust will pay the first-to-die's share to the charitable organizations identified in Article VIII of Trust, in the same proportion prescribed for Share A; (c) upon the death of the last-to-die of Child 1 and Child 2, Reformed Charitable Trust will terminate and the remainder will be distributed to the charitable organizations identified in Article VIII of Trust, in the same proportion prescribed for Share A; and (d) no amount may be paid to or on behalf of any beneficiary under the provisions of Article XX of Trust. In addition, Reformed Charitable Trust, as provided in proposed amended and restated Article VII of Trust, includes provisions substantially similar to those found in Rev. Proc. 2005-59, 2005-2 C.B. 412 (offering a sample declaration of trust for a testamentary charitable remainder unitrust with concurrent and consecutive interests for two measuring lives followed by the distribution of trust assets to one or more charitable remaindermen).

On Date 4, a date before the 90th day after the last date (including extensions) for filing Decedent's estate tax return,² Child 1, as personal representative of Decedent's estate and co-trustee of Trust, commenced a judicial proceeding in Court to reform the trust. On Date 5, Court approved the reformation of Trust and determined as follows:

1. That Amended Agreement, and reformation of Article VII of Trust as restated in an attachment to Amended Agreement, is approved.
2. That the provision in Amended Agreement agreeing to fund Charitable Trust with \$b as of the date of funding, less Decedent's testamentary transfers to noncharitable beneficiaries and taxable gifts, is final.
3. That the provision in Amended Agreement seeking Charitable Trust to be divided into Article XX Trust and Reformed Charitable Trust, retroactive to the date of death, is approved.
4. That the funding of Article XX Trust with \$c is fair and reasonable and will ensure that amounts may be paid to Child 1 and Child 2 as authorized under Article XX of Trust.
5. That each of the sub-trusts created under Trust each will be entitled to its share of income earned on the assets funding the trust from the date of Decedent's death.
6. That all interested parties were before the Court and that Court had subject matter jurisdiction in the case.

Court's order was contingent on the issuance of a private letter ruling by the Internal Revenue Service holding that the reformation of Trust constitutes a qualified reformation under § 2055(e)(3).

You have requested the following rulings:

1. The judicial reformation of Trust is a qualified reformation for purposes of § 2055(e)(3).
2. A deduction is allowable under § 2055(a) for the present value of the remainder interest in Reformed Charitable Trust.

LAW AND ANALYSIS

² For decedents dying between January 1, 2010, and December 16, 2010, the due date for Form 706 is September 19, 2011.

Section 664(d)(2) provides, in relevant part, that a CRUT is a trust:

- (A) from which a fixed percentage (which is not less than 5 percent nor more than 50 percent) of the net fair market value of its assets, valued annually, is to be paid, not less often than annually, to one or more persons (at least one of which is not an organization described in § 170(c) and, in the case of individuals, only to an individual who is living at the time of the creation of the trust) for a term of years (not in excess of 20 years) or for the life or lives of such individual or individuals,
- (B) from which no amount other than the payments described in § 664(d)(2)(A) and other than qualified gratuitous transfers described in § 664(d)(2)(C) may be paid to or for the use of any person other than an organization described in § 170(c),
- (C) following the termination of the payments described in § 664(d)(2)(A), the remainder interest in the trust is to be transferred to, or for the use of, an organization described in § 170(c) or is to be retained by the trust for such a use, and
- (D) with respect to each contribution of property to the trust, the value (determined under § 7520) of such remainder interest in such property is at least 10 percent of the net fair market value of such property as of the date such property is contributed to the trust.

Section 2055(a) provides that the value of the taxable estate shall be determined by deducting from the value of the gross estate the amount of all bequests, legacies, devises, and transfers to or for the use of any corporation or certain other organizations organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes.

Section 2055(e)(2) provides that where an interest in property passes or has passed from the decedent to a person, or for a use, described in § 2055(a), and an interest (other than an interest that is extinguished upon the decedent's death) in the same property passes or has passed (for less than an adequate and full consideration in money or money's worth) from the decedent to a person, or for a use, not described in § 2055(a), no deduction is allowed under § 2055(a) for the interest that passes or has passed to the person, or for a use, described in § 2055(a), unless in the case of a remainder interest, the interest is in a charitable remainder annuity trust or a charitable remainder unitrust (described in § 664) or a pooled income fund (described in § 642(c)(5)). In the case of an interest other than a remainder interest, the interest must be in the form of a guaranteed annuity or a fixed percentage distributed annually of the net fair market value of the trust assets (determined annually).

Section 2055(e)(3)(A) provides that a deduction shall be allowed under § 2055(a) with respect to any qualified reformation.

Section 2055(e)(3)(B) provides that the term “qualified reformation” means a change of a governing instrument by reformation, amendment, construction, or otherwise that changes a reformable interest into a qualified interest, but only if --

(i) any difference between (I) the actuarial value (determined as of the date of the decedent's death) of the qualified interest, and (II) the actuarial value (as so determined) of the reformable interest does not exceed 5 percent of the actuarial value (as so determined) of the reformable interest,

(ii) in the case of (I) a charitable remainder interest, the nonremainder interest (before and after the qualified reformation) terminated at the same time, or, (II) any other interest, the reformable interest and the qualified interest are for the same period, and

(iii) the change is effective as of the date of the decedent's death.

Section 2055(e)(3)(C)(i) provides that the term “reformable interest” means any interest for which a deduction would be allowable under § 2055(a) at the time of the decedent's death but for § 2055(e)(2).

Section 2055(e)(3)(C)(ii) provides, in part, that the term “reformable interest” does not include any interest unless, before the remainder vests in possession, all payments to persons other than an organization described in § 2055(a) are expressed either in specified dollar amounts or a fixed percentage of the fair market value of the property.

Section 2055(e)(3)(C)(iii) provides, in part, that § 2055(e)(3)(C)(ii) does not apply to any interest if a judicial proceeding is commenced to change the interest into a qualified interest not later than 90 days after the last date (including extensions) for filing an estate tax return, if an estate tax return is required to be filed.

Section 2055(e)(3)(D) provides that the term “qualified interest” means an interest for which a deduction is allowable under § 2055(a).

Section 2055(e)(3)(E) provides that the deduction referred to in § 2055(e)(3)(A) shall not exceed the amount of the deduction that would have been allowable for the reformable interest but for § 2055(e)(2).

Section 20.2055-2(a) of the Estate Tax Regulations provides that if a trust is created or property is transferred for both a charitable and a private purpose, a deduction may be taken of the value of the charitable beneficial interest only insofar as that interest is presently ascertainable and hence severable from the noncharitable interest as of the date of death.

In this case, the charitable remainder interest in Trust is a reformable interest under § 2055(e)(3)(C). As originally drafted, Article VII of Trust provided for a charitable remainder interest that was presently ascertainable and severable from the noncharitable interest. Accordingly, the remainder interest passing to Charity 1, Charity 2, and Charity 3 would have qualified for an estate tax charitable deduction under § 2055(a), but for the requirements of §§ 664 and 2055(e)(2). In addition, the reformation proceeding was commenced within the time prescribed in § 2055(e)(3)(C)(iii), so the requirement in § 2055(e)(3)(C)(ii) does not apply to exclude the remainder interest as a reformable interest.

Further, the reformation satisfies the requirements for a qualified reformation under § 2055(e)(3)(B). The actuarial value of the charitable remainder interest in Reformed Charitable Trust will not differ by more than 5 percent from the actuarial value of the charitable remainder interest in Charitable Trust provided for prior to reformation, determined under § 7520, using reasonable valuation assumptions. In addition, under the terms of Reformed Charitable Trust, the interests of Child 1 and Child 2 will terminate at the same time as they would have terminated under the terms of the original trust instrument. Finally, the reformation will be effective as of the date of Decedent's death.

Accordingly, based on the information submitted and representations made, we conclude that the reformation of Trust, as described above, constitutes a qualified reformation within the meaning of § 2055(e)(3). We further conclude that an estate tax charitable deduction is allowable under § 2055(a) for the present value of the charitable remainder interest, as determined under § 20.2055-2(f)(2)(ii), provided Reformed Charitable Trust qualifies as a charitable remainder unitrust described in § 664(d)(2). The amount of the deduction is subject to the limitation in § 2055(e)(3)(E), if applicable.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Leslie H. Finlow
Senior Technician Reviewer, Branch 4
(Passthroughs & Special Industries)